

PENDLETON COUNTY BOARD OF EDUCATION

FINANCIAL STATEMENTS
SUPPLEMENTARY INFORMATION
And
INDEPENDENT AUDITOR'S REPORTS

Year Ended June 30, 2003

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INDEPENDENT AUDITOR'S REPORT

State Committee For School District Audits
Members of the Board of Education
Pendleton County Board of Education
Falmouth, Kentucky

I have audited the accompanying basic financial statements of the Pendleton County School District as of June 30, 2003 and for the year then ended, as listed in the accompanying table of contents. These basic financial statements are the responsibility of the Board's management. My responsibility is to express an opinion on these general purpose financial statements based on my audit.

I conducted my audit in accordance with auditing standards generally accepted in the United States of America, and the standards applicable to financial audits contained in Government Auditing Standards, issued by the Comptroller General of the United States; the provisions of Office of Management and Budget Circular A-133, Audits of States, Local Governments, and Non-Profit Organizations, and the audit requirements prescribed by the Kentucky State Committee for School District Audits in Appendix I, II, and III to the independent auditor's contract. Those standards require that I plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. I believe that my audit provides a reasonable basis for my opinion.

In my opinion, the basic financial statements referred to above present fairly, in all material respects, the financial position of the Board as of June 30, 2003 and the results of its operations and the cash flows of its proprietary fund types for the year then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with Government Auditing Standards, I have also issued a report dated October 27, 2003 on my consideration of Pendleton County School District's internal control over financial reporting and on my tests of its compliance with certain provisions of laws, regulations, contracts and grants. That report is an integral part of an audit performed with Government Auditing Standards and should be read in conjunction with this report in considering the results of my audit.

As described in Note B, the Board has implemented a new financial reporting model, as required by the provisions of GASB Statement No. 34, Basic Financial Statements – and Management's Discussion and Analysis – for State and Local Governments, as of June 30, 2003. This results in a change in the format and content of the basic financial statements.

The management's discussion and analysis on pages 3 through 7 is not a required part of the basic financial statements but are supplementary information required by U.S. generally accepted accounting principles. I have applied certain limited procedures, which consisted principally of inquiries or management regarding the methods of measurement and presentation of the supplementary information. However, I did not audit the information and express no opinion on it.

My audit was performed for the purpose of forming an opinion on the basic financial statements taken as a whole. The additional information listed as supplementary information in the table of contents is presented for purposes of additional analysis and is not a required part of the financial statements. The accompanying schedule of expenditures of federal awards is presented for purposes of additional analysis as required by U.S. Office of Management and Budget Circular A-133, Audits of States, Local Governments, and Non-Profit Organizations, and is not a required part of the general purpose financial statements. Such information has been subjected to the auditing procedures applied in the audit of the financial statements and, in my opinion, is fairly stated in all material respects in relation to the financial statements taken as a whole.

This report is intended for the information of management, the Kentucky Department of Education, federal awarding agencies, and pass-through entities and is not intended to be and should not be used by anyone other than these specified parties.

Denise M. Keene, CPA
October 27, 2003

**PENDLETON COUNTY BOARD OF EDUCATION
FALMOUTH, KENTUCKY**

**MANAGEMENT'S DISCUSSION AND ANALYSIS (MD&A)
YEAR ENDED JUNE 30, 2003**

As management of the Pendleton County School District (District), we offer readers of the District's financial statements this narrative overview and analysis of the financial activities of the District for the fiscal year ended June 30, 2003. We encourage readers to consider the information presented here in conjunction with additional information found within the body of the audit.

FINANCIAL HIGHLIGHTS

- The beginning cash balance for the District was \$4,124,893.
- The District initiated the energy saving renovation at all schools and the central office during the year. The total expected cost for the project is \$1,392,284. The bond proceeds received to finance this project totaled \$1,390,000.
- The General Fund had \$14,897,810 in revenue, which primarily consisted of the state program (SEEK), property, utilities, and motor vehicle taxes. Excluding inter-fund transfer, there were \$14,791,146 in General Fund expenditures.
- The General Fund transferred \$200,000 into the Construction Fund for the Athletic Park project.
- Employees were given a 2.7% raise for the current fiscal year.

OVERVIEW OF FINANCIAL STATEMENTS

This discussion and analysis is intended to serve as an introduction to the District's basic financial statements. The District's basic financial statements comprise three components: 1) district-wide financial statements, 2) fund financial statements, and 3) notes to the financial statements. This report also contains other supplementary information in addition to the basic financial statements themselves.

District-wide financial statements. The district-wide financial statements are designed to provide readers with a broad overview of the District's finances, in a manner similar to a private-sector business.

The statement of net assets presents information on all of the District's assets and liabilities, with the difference between the two reported as net assets. Over time, increases or decreases in net assets may serve as a useful indicator of whether the financial position of the district is improving or deteriorating.

The statement of activities presents information showing how the District's net assets changed during the most recent year. All changes in net assets are reported as soon as the underlying event giving rise to the change occurs, regardless of the timing of related cash flows. Thus, revenues and expenses are reported in this statement for some items that will only result in cash flows in future fiscal periods.

The district-wide financial statements outline functions of the District that are principally supported by property taxes and intergovernmental revenues (governmental activities). The governmental activities of the District include instruction, support services, operation and maintenance of plant, student transportation and operation of non-instructional services. Fixed assets and related debt is also supported by taxes and intergovernmental revenues.

The district-wide financial statements can be found on pages 8 and 9 of this report.

Fund financial statements. A fund is a grouping of related accounts that is used to maintain control over resources that have been segregated for specific activities or objectives. This is a state mandated uniform system and chart of accounts for all Kentucky public school districts utilizing the MUNIS administrative software. The District uses fund accounting to ensure and demonstrate compliance with finance-related legal requirements. All of the funds of the District can be divided into three categories: governmental, proprietary funds and fiduciary funds. Fiduciary funds are trust funds established by benefactors to aid in student education, welfare and teacher support. The proprietary funds are food service operations, day care, and adult/community education. All other activities of the district are included in the governmental funds.

The basic governmental fund financial statements can be found on pages 10-19 of this report.

Notes to the financial statements. The notes provide additional information that is essential to a full understanding of the data provided in the district-wide and fund financial statements. The notes to the financial statements can be found on pages 20-37 of this report.

DISTRICT-WIDE FINANCIAL ANALYSIS

Net assets may serve over time as a useful indicator of a government's financial position. In the case of the District, assets exceeded liabilities by \$9 million as of June 30, 2003.

The largest portion of the District's net assets reflects its investment in capital assets less any related debt used to acquire those assets that is still outstanding. The District uses these capital assets to provide services to its students; consequently, these assets are not available for future spending. Although the District's investment in its capital assets is reported net of related debt, it should be noted that the resources needed to repay this debt must be provided from other sources, since the capital assets themselves cannot be used to liquidate these liabilities.

The District's financial position is the product of several financial transactions including the net results of activities, the acquisition and payment of debt, the acquisition and disposal of capital assets, and the depreciation of capital assets.

Net Assets for the period ending June 30, 2003

The current year's financial statements are dramatically different from past years as a result of implementing GASB 34. Attempting to compare this year's data with last year would be misleading to the reader however the district looks forward to offering comparative data in the future.

Net Assets (In Thousands)			
Assets	Governmental Business-Type		Total
Current Assets	\$4,012	\$689	\$4,701
Noncurrent Assets	<u>17,246</u>	<u>877</u>	<u>18,123</u>
Total Assets	\$21,258	\$1,566	\$22,824
Liabilities			
Current Liabilities	\$1,607		\$1,607
Noncurrent Liabilities	<u>12,151</u>		<u>12,151</u>
Total Liabilities	\$13,758		\$13,758
Net Assets			
Investment in capital assets (net of debt)	\$4,435	\$877	\$5,312
Restricted	1,184		1,184
Unreserved Fund Balance	<u>1,881</u>	<u>689</u>	<u>2,570</u>
Total Net Assets	\$7,500	\$1,566	\$9,066

The following are significant current year transactions that have had an impact on the Statement of Net Assets.

The District implemented GASB 34 and recorded fixed assets and debt for the first time.

Budgetary Implications

In Kentucky the public school fiscal year is July 1 – June 30; other programs, i.e. some federal operate on a different fiscal year, but are reflected in the district overall budget. By law the budget must have a minimum 2 percent contingency. The district adopted a budget with \$1,128,429 in contingency, which is 6.3 percent. The beginning cash balance for the fiscal year was \$4,124,893.

Comments on Budget Comparisons

The original budget was amended to reflect changes in the site based allocations and anticipated revenues. The changes made were based on more accurate data being available after the first couple of months of the fiscal year.

The District recorded "On-Behalf" payments as revenues and expenditures during the fiscal year. "On-Behalf" payments were not included in the budget. Therefore budget comparisons have some large negative variances. Caution should be used when reading the budget comparison reports.

The following table presents a summary of revenue and expense for the fiscal year ended June 30, 2003.

Changes in Net Assets (In Thousands)			
Revenues	Governmental	Business-Type	Total
Local Revenues Sources	\$3,058	\$609	\$3,667
State Revenue Sources	14,714	17	14,731
Federal Revenue Sources	1,374	597	1,971
Investments	<u>96</u>	<u>13</u>	<u>109</u>
Total Revenues	19,242	1,236	20,478
Expenses			
Instruction	10,098		10,098
Student Support Services	581		581
Instructional Support	755		755
District Administration	622		622
School Administration	721		721
Business Support	77		77
Plant Operations	1,390		1,390
Student Transportation	1,446		1,446
Central Office Support	366		366
Community Support	362	46	408
Food Service	24	1,027	1,051
Other	<u>1,594</u>	<u> </u>	<u>1,594</u>
Total Expenses	18,036	1,073	19,109
Transfers	64	(64)	0
Change in Net Assets	1,270	99	1,369
Beginning Net Assets	<u>6,230</u>	<u>1,467</u>	<u>7,697</u>
Ending Net Assets	\$7,500	\$1,566	\$9,066

The government's overall financial position and results of operations improved as a result of the year's operations as reflected in the increase in net assets for the year.

INFRASTRUCTURE

The District has not reported any infrastructure in the current financial statements.

Analysis of balances and transactions of individual funds

(In thousands)

Fund	Beginning	Revenues	Expenses	Transfer	Ending
General Fund	\$1,698	\$15,026	\$14,791	(\$190)	\$1,743
Special Revenue	\$0	\$2,535	\$2,556	\$21	\$0
Capital Outlay	\$0	\$267	\$17	(\$250)	\$0
Building	\$821	\$1,290	\$0	(\$1,135)	\$976
Construction	\$529	\$1,391	\$2,080	\$766	\$606
Debt Service	\$142	\$252	\$1,177	\$852	\$69

Capital Assets and Long -Term Debt Activity

(In thousands)

	Beginning	Additions	Deductions	Ending
Governmental				
Capital Assets	\$23,465	\$4,172	\$1,418	\$26,219
Accumulated Depreciation	\$7,988	\$986		\$8,974
Business-Type				
Capital Assets	\$1,359	\$87		\$1,446
Accumulated Depreciation	\$508	\$60		\$568
Bonds Payable	\$11,095	\$1,390	\$615	\$11,870
Capital Leases Payable	\$994	\$129	\$182	\$941

CURRENT ISSUES

The District approved an increase in tax for the 2003-2004 fiscal year. This included the allowable first and second growth nickel which equates to 12 cents.

The Northern Ceiling Tile project was started and completed in the first two months of 2003-2004 year.

The District has committed funds to complete three new construction projects:

PCHS renovation	\$ 5,629,685
SES renovation	\$ 1,577,161
NES renovation	\$ 1,577,161

The District has committed General Fund money to support Special Education and Preschool services for \$200,000.

At the beginning of the 2003-2004 fiscal year all classified employees were given a 2.7% raise. Certified employees earning less than \$40,000 were given a \$1,080 raise. Certified employees earning more than \$40,000 were given a 2.7% raise.

Contacting the District's Financial Management

This financial report is designed to provide our citizens, taxpayers, investors, and creditors with a general overview of the Board's finances and to reflect the Board's accountability for the monies it receives. Questions about this report or additional financial information needs should be directed to the Superintendent, Patrick Clore, or to the Treasurer, Patricia Gosney, 859-654-6911, or by mail at 2525 Hwy 27 N, Falmouth, Kentucky 41040.

PENDLETON COUNTY SCHOOL DISTRICT
NOTES TO THE FINANCIAL STATEMENTS
June 30, 2003

NOTE A – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

REPORTING ENTITY

The Pendleton County Board of Education (Board), a five member group, is the level of government which has oversight responsibilities over all activities related to public elementary and secondary school education within the jurisdiction of the Pendleton County School District (District). The Board receives funding from local, state and federal government sources and must comply with the commitment requirements of these funding source entities. However, the Board is not included in any other governmental "reporting entity" as defined in Section 2100, Codification of Governmental Accounting and Financial Reporting Standards as Board members are elected by the public and have decision making authority, the power to designate management, the responsibility to develop policies which may influence operations, and primary accountability for fiscal matters.

The Board, for financial purposes, includes all of the funds and account groups relevant to the operation of the Pendleton County Board of Education. The financial statements presented herein do not include funds of groups and organizations, which although associated with the school system, have not originated within the Board itself such as Band Boosters, Parent-Teacher Associations, etc.

The financial statements of the Board include those of separately administered organizations that are controlled by or dependent on the Board. Control or dependence is determined on the basis of budget adoption, funding and appointment of the respective governing board.

Based on the foregoing criteria, the financial statements of the following organization are included in the accompanying financial statements:

Pendleton County School District Finance Corporation (the Corporation) – the Pendleton County Board of Education has established the Pendleton County School District Finance Corporation (a non-profit, non-stock, public and charitable corporation organized under the School Bond Act and KRS 273 and KRS Section 58.180) as an agency of the Board for financing the costs of school building facilities. The Board Members of the Pendleton County Board of Education also comprise the Corporation's Board of Directors.

Basis of Presentation

District-Wide Financial Statements – The statement of net assets and the statement of activities display information about the District as a whole. These statements include the financial activities of the primary government, except for fiduciary funds. The statements distinguish between those activities of the Board that are governmental and those that are considered business-type activities.

The district-wide statements are prepared using the economic resources measurement focus. This is the same approach used in the preparation of the proprietary fund financial statements but differs from the manner in which governmental fund financial statements are prepared. Governmental fund financial statements therefore include reconciliations with brief explanations to better identify the relationship between the district-wide statements and the statements for governmental funds.

PENDLETON COUNTY SCHOOL DISTRICT
NOTES TO THE FINANCIAL STATEMENTS
June 30, 2003

The district-wide statement of activities presents a comparison between direct expenses and program revenues for each segment of the business-type activities of the District and for each function or program of the District's governmental activities. Direct expenses are those that are specifically associated with a service, program or department and are therefore clearly identifiable to a particular function. Program revenues include charges paid by the recipient of the goods or services offered by the program and grants and contributions that are restricted to meeting the operational or capital requirements of a particular program. Revenues that are not classified as program revenues are presented as general revenues of the District, with certain limited exceptions. The comparison of direct expenses with program revenues identifies the extent to which each business segment or governmental function is self-financing or draws from the general revenues of the District.

Fund Financial Statements – Fund financial statements report detailed information about the District. The focus of governmental and proprietary fund financial statements is on major funds rather than reporting funds by type. Each major fund is presented in a separate column. Nonmajor funds are aggregated and presented in a single column. Fiduciary funds are reported by fund type.

The accounting and reporting treatment applied to a fund is determined by its measurement focus. All governmental fund types are accounted for using a flow of current financial resources measurement focus. The financial statements for governmental funds are a balance sheet, which generally includes only current assets and current liabilities, and a statement of revenues, expenditures and changes in fund balances, which reports on the changes in net total assets. Proprietary funds and fiduciary funds are reported using the economic resources measurement focus. The statement of cash flows provides information about how the District finances and meets the cash flow needs of its proprietary activities.

The District has the following funds:

I. Governmental Fund Types

- (A) The General Fund is the primary operating fund of the District. It accounts for financial resources used for general types of operations. This is a budgeted fund and any unrestricted fund balances are considered as resources available for use. This is a major fund of the District.
- (B) The Special Revenue Fund accounts for proceeds of specific revenue sources (other than expendable trusts or major capital projects) that are legally restricted to disbursements for specified purposes. It includes federal financial programs where unused balances are returned to the grantor at the close of specified project periods as well as the state grant programs. Project accounting is employed to maintain integrity for the various sources of funds. The separate projects of federally-funded grant programs are identified in the Schedule of Expenditures of Federal Awards included in this report. This is a major fund of the District.

PENDLETON COUNTY SCHOOL DISTRICT
NOTES TO THE FINANCIAL STATEMENTS
June 30, 2003

- (C) Capital Project Funds are used to account for financial resources to be used for the acquisition or construction of major capital facilities and equipment (other than those financed by Proprietary Funds).
1. The Support Education Excellence in Kentucky (SEEK) Capital Outlay Fund receives those funds designated by the state as Capital Outlay Funds and is restricted for use in financing projects identified in the district's facility plan.
 2. The Facility Support Program of Kentucky (FSPK) Fund accounts for funds generated by the building tax levy required to participate in the School Facilities Construction Commission's construction funding and state matching funds, where applicable. Funds may be used for projects identified in the district's facility plan.
 3. The Construction Fund includes Capital Projects Fund accounts for proceeds from sales of bonds and other revenues to be used for authorized construction and/or renovations. This is a major fund of the District

II. Debt Service Fund

The Debt Service Fund is used to account for the accumulation of resources for, and the payment of, general long-term debt principal and interest and related cost; and, for the payment of interest on general obligation notes payable, as required by Kentucky Law.

III. Proprietary Funds (Enterprise Fund)

1. The School Food Service Fund is used to account for school food service activities, including the National School Lunch Program, which is conducted in cooperation with the U.S. Department of Agriculture (USDA). This is a major fund for the District.
2. The Child Care Fund is used to account for after school child care activities.
3. The Adult/Community Education Fund is use to account for adult and community education activities.

IV. Fiduciary Fund Type (Agency and Private Purpose Trust Funds)

1. The Agency Fund accounts for activities of student groups and other types of activities requiring clearing accounts. These funds are accounted for in accordance with Uniform Program of Accounting for School Activity Funds.
2. The Private Purpose Trust Funds are used to report trust arrangements under which principal and income benefit individuals, private organizations or other governments.

The District does not current have any Private Purpose Trust Funds.

PENDLETON COUNTY SCHOOL DISTRICT
NOTES TO THE FINANCIAL STATEMENTS
June 30, 2003

Basis of Accounting

Basis of accounting determines when transactions are recorded in the financial records and reported on the financial statements. District-wide financial statements are prepared using the accrual basis of accounting. Governmental funds use the modified accrual basis of accounting. Proprietary and fiduciary funds also use the accrual basis of accounting.

Revenues – Exchanges and Non-exchange Transactions – Revenues resulting from exchange transactions, in which each party receives essentially equal value, are recorded on the accrual basis when the exchange takes place. On a modified accrual basis, revenues are recorded in the fiscal year in which the resources are measurable and available. Available means that the resources will be collected within the current fiscal year or are expected to be collected soon enough thereafter to be used to pay liabilities of the current fiscal year. For the District available means expected to be received within sixty days of the fiscal year-end.

Nonexchange transactions, in which the District receives value without directly giving equal value in return, include property taxes, grants, entitlements and donations. On an accrual basis, revenue from property taxes is recognized in the fiscal year for which the taxes are levied. Revenue from grants, entitlements and donations is recognized in the fiscal year in which all eligibility requirements have been satisfied. Eligibility requirements include timing requirements, which specify the year when the resources are required to be used or the fiscal year when used is first permitted, matching requirements, in which the District must provide local resources to be used for a specified purpose, and expenditure requirements, in which the resources are provided to the District on a reimbursement basis. On a modified accrual basis, revenues from nonexchange transactions must also be available before they can be recognized.

Deferred Revenue – Deferred revenue arises when assets are recognized before revenue recognition criteria have been satisfied.

Grants and entitlements received before the eligibility requirements are met are recorded as deferred revenue.

Expenses/Expenditures – On the accrual basis of accounting, expenses are recognized at the time they are incurred. The fair value of donated commodities used during the year is reported in the statement of revenues, expenses, and changes in net assets as an expense with a like amount reported as donated commodities revenue.

The measurement focus of governmental fund accounting is on decreases in net financial resources (expenditures) rather than expenses. Expenditures are generally recognized in the

accounting period in which the related fund liability is incurred, if measurable. Allocations of cost, such as depreciation, are not recognized in governmental funds.

PENDLETON COUNTY SCHOOL DISTRICT
NOTES TO THE FINANCIAL STATEMENTS
June 30, 2003

Property Taxes

Property Tax Revenues – Property taxes are levied each September on the assessed value listed as of the prior January 1, for all real and personal property in the county. The billings are considered due upon receipt by the taxpayer; however, the actual date is based on a period ending 30 days after the tax bill mailing. Property taxes collected are recorded as revenues in the fiscal year for which they were levied.

The property tax rates assessed for the year ended June 30, 2003, to finance the General Fund operations were \$.39 per \$100 valuation for real property, \$.39 per \$100 valuation for business personal property and \$.55 per \$100 valuation for motor vehicles.

The District levies a utility gross receipts license tax in the amount of 3% of the gross receipts derived from the furnishings, within the county, of telephonic and telegraphic communications services, cablevision services, electric power, water, and natural, artificial and mixed gas.

Capital Assets

General capital assets are those assets not specifically related to activities reported in the proprietary funds. These assets generally result from expenditures in the governmental funds. These assets are reported in the governmental activities column of the government-wide statement of net assets but are not reported in the fund financial statements. Capital assets utilized by the proprietary funds are reported both in the business-type activities column of the government-wide statement of net assets and in the respective funds.

All capital assets are capitalized at cost (or estimated historical cost) and updated for additions and retirements during the year. Donated fixed assets are recorded at their fair market values as of the date received. The District maintains a capitalization threshold of one thousand dollars with the exception of computers, digital cameras and real property for which there is no threshold. The District does not possess any infrastructure. Improvements are capitalized; the cost of, normal maintenance and repairs that do not add to the value of the asset or materially extend an asset's life are not.

PENDLETON COUNTY SCHOOL DISTRICT
 NOTES TO THE FINANCIAL STATEMENTS
 June 30, 2003

All reported capital assets are depreciated. Improvements are depreciated over the remaining useful lives of the related capital assets. Depreciation is computed using the straight-line method over the following useful lives for both general capital assets and proprietary fund assets:

<u>Description</u>	<u>Governmental Activities Estimated Lives</u>
Buildings and improvements	25-50 years
Land improvements	20 years
Technology equipment	5 years
Vehicles	5-10 years
Audio-visual equipment	15 years
Food service equipment	12 years
Furniture and fixtures	20 years
Rolling stock	15 years
Other	10 years

Interfund Balances

On fund financial statements, receivables and payables resulting from short-term interfund loans are classified as "interfund receivables/payables". These amounts are eliminated in the governmental and business-type activities columns of the statements of net assets, except for the net residual amounts due between governmental and business-type activities, which are presented as internal balances.

Accumulated Unpaid Sick Leave Benefits

Upon retirement from the school system, an employee will receive from the District an amount equal to 30% of the value of accumulated sick leave.

Sick leave benefits are accrued as a liability using the termination payment method. An accrual for earned sick leave is made to the extent that it is probable that the benefits will result in termination payments. The liability is based on the School District's past experience of making termination payments.

The entire compensated absence liability is reported on the government-wide financial statements.

For governmental fund financial statements the current portion of unpaid accrued sick leave is the amount expected to be paid using expendable available resources. These amounts are recorded in the account "accumulated sick leave payable" in the general fund. The noncurrent portion of the liability is not reported.

PENDLETON COUNTY SCHOOL DISTRICT
NOTES TO THE FINANCIAL STATEMENTS
June 30, 2003

Budgetary Process

Budgetary Basis of Accounting: The District's budgetary process accounts for certain transactions on a basis other than Generally Accepted Accounting Principles (GAAP). The major differences between the budgetary basis and the GAAP basis are:

Revenues are recorded when received in cash (budgetary) as opposed to when susceptible to accrual (GAAP).

Expenditures are recorded when paid in cash (budgetary) as opposed to when susceptible to accrual (GAAP).

Once the budget is approved, it can be amended. Amendments are presented to the Board at their regular meetings. Such amendments are made before the fact, are reflected in the official minutes of the Board, and are not made after fiscal year-end as dictated by law.

Each budget is prepared and controlled by the treasurer at the revenue and expenditure function/object level. All budget appropriations lapse at year-end.

Cash and Cash Equivalents

The District considers demand deposits, money market funds, and other investments with an original maturity of 90 days or less, to be cash equivalents.

Inventories

On district-wide financial statements inventories are stated at cost and are expensed when used.

On fund financial statements inventories are stated at cost. The cost of inventory items is recorded as an expenditure in the governmental fund types when purchased.

The food service fund uses the specific identification method and the general fund uses the first-in, first-out method.

Prepaid Assets

Payments made that will benefit periods beyond June 30, 2003 are recorded as prepaid items using the consumption method. Prepaid assets are only recorded if material to the financial statements.

PENDLETON COUNTY SCHOOL DISTRICT
NOTES TO THE FINANCIAL STATEMENTS
June 30, 2003

Accrued Liabilities and Long-Term Obligations

All payables, accrued liabilities and long-term obligations are reported in the district-wide financial statements, and all payables, accrued liabilities and long-term obligations payable from proprietary funds are reported on the proprietary fund financial statements.

In general, payables and accrued liabilities that will be paid from governmental funds are reported on the governmental fund financial statements regardless of whether they will be liquidated with current resources. However, claims and judgments, the noncurrent portion of capital leases, accumulated sick leave, contractually required pension contributions and special termination benefits that will be paid from governmental funds are reported as a liability in the fund financial statements only to the extent that they will be paid with current, expendable, available financial resources. In general, payments made within sixty days after year-end are considered to have been made with current available financial resources. Bonds and other long-term obligations that will be paid from governmental funds are not recognized as a liability in the fund financial statements until due.

Fund Balance Reserves

The District reserves those portions of fund equity which are legally segregated for a specific future use or which do not represent available expendable resources and therefore are not available for appropriation or expenditure. Unreserved fund balance indicates that portion of fund equity which is available for appropriation in future periods.

Net Assets

Net assets represent the difference between assets and liabilities. Net assets invested in capital assets, net of related debt consists of capital assets, net of accumulated depreciation, reduced by the outstanding balances of any borrowings used for the acquisition, construction or improvement of those assets. Net assets are reported as restricted when there are limitations imposed on their use either through the enabling legislation adopted by the District or through external restrictions imposed by creditors, grantors or laws or regulations of other governments.

Operating Revenues and Expenses

Operating revenues are those revenues that are generated directly from the primary activity of the proprietary funds. For the District, those revenues are primarily charges for meals provided by the various schools and collections for services such as child care and adult/community education courses.

Contributions of Capital

Contributions of capital in proprietary fund financial statements arise from outside contributions of fixed assets, or from grants or outside contributions of resources restricted to capital acquisition and construction.

PENDLETON COUNTY SCHOOL DISTRICT NOTES TO THE FINANCIAL STATEMENTS June 30, 2003

Interfund Activity

Flows of cash or goods from one fund to another without a requirement for repayment are reported as interfund transfers. Interfund transfers are reported as other financing sources/uses in governmental funds and after nonoperating revenues/expenses in proprietary funds. Repayments from funds responsible for particular expenditures/expenses to the funds that initially paid for them are not presented on the financial statements.

Uses of Estimates

The process of preparing financial statements in conformity with general accepted accounting principles of the United States of America requires management to make estimates and assumptions that affect reported amounts of assets, liabilities, designated fund balances, and disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenues and expenditures during the reporting period. Actual results could differ from those estimates.

Encumbrances

Encumbrances are not liabilities and therefore, are not recorded as expenditures until receipt of material or service. For budgetary purposes, appropriations lapse at fiscal year-end and outstanding encumbrances at year-end are reappropriated in the next year. Accordingly, no differences exist between actual results and the applicable budgetary data presented in the accompanying combined financial statements.

NOTE B – CHANGES IN ACCOUNTING PRINCIPLES AND RESTATEMENT OF FUND BALANCE

For the fiscal year ended June 30, 2003, the District implemented GASB Statement No. 33, "Accounting and Financial Reporting for Nonexchange Transactions". For the fiscal year ended June 30, 2003 the District has implemented GASB Statement No. 34, "Basic Financial Statements – and Management's Discussion and Analysis – for State and Local Governments".

GASB 34 creates new basic financial statements for reporting on the District's financial activities. The financial statements now include district-wide financial statements prepared on an accrual

basis of accounting and fund financial statements which present information for individual major funds rather than by fund type. Nonmajor funds are presented in total in one column.

The district-wide financial statements split the District's programs between business-type and governmental activities. The beginning net asset amount for governmental programs reflects the change in fund balance for governmental funds at June 30, 2002, caused by the conversion to the accrual basis of accounting.

PENDLETON COUNTY SCHOOL DISTRICT
NOTES TO THE FINANCIAL STATEMENTS
June 30, 2003

Restatement of Fund Balance – The restatement for the above changes and the transition from governmental fund balance to net assets of the governmental activities is presented below:

	<u>General</u>	<u>Special Revenue</u>	<u>Construction</u>	<u>Nonmajor</u>	<u>Total</u>
Fund Balance June 30, 2002	\$ 1,698,017	\$ -	\$ 528,634	\$ 963,588	\$3,190,239
No Adjustment Necessary					
Adjusted Fund Balance, June 30, 2002	\$ <u>1,698,017</u>	\$ <u> </u>	\$ <u>528,634</u>	\$ <u>963,588</u>	3,190,239
GASB 34 Adjustments:					
Capital Assets – Net of Depreciation					15,477,223
Bond and Capital Leases Payable					(12,088,313)
Accumulated sick leave - long-term portion					(295,871)
Accrued interest payable					<u>(53,143)</u>
Governmental Activities Net Assets, June 30, 2002					\$ <u>6,230,135</u>

The District had a fixed asset inventory taken to comply with GASB 34. This inventory revealed the existence of proprietary fixed assets that have not previously been recorded on the books. Changes as a result of the GASB 34 implementation are as follows:

	<u>Food Service</u>	<u>Non- Major</u>	<u>Total</u>
Fund Balance, June 30, 2002	\$ 843,668	\$ 0	\$ 843,668
Additional fixed assets	<u>623,174</u>	<u>-</u>	<u>623,174</u>
Adjusted Fund Balance, June 30, 2002	\$ <u>1,466,842</u>	\$ <u>0</u>	\$ <u>1,466,842</u>

As proprietary funds are already on the accrual basis, no adjustments are necessary for the Statement of Net Assets.

PENDLETON COUNTY SCHOOL DISTRICT
NOTES TO THE FINANCIAL STATEMENTS
June 30, 2003

NOTE C – CASH AND CASH EQUIVALENTS

At year-end, the carrying amount of the District's total cash and cash equivalents was \$4,450,817. Of the total cash balance, \$200,000 was covered by Federal Depository insurance, with the remainder covered by collateral agreements and collateral held by the pledging banks' trust departments in the District's name. Cash equivalents are funds temporarily invested in securities with a maturity of 90 days or less.

Cash and cash equivalents at June 30, 2003 consisted of the following:

	Bank Balance	Book Balance
General Checking Account		
General Fund	\$	\$ 1,756,487
Fund 2		143,244
Fund 320		975,596
Fund 360		581,167
Fund 51		650,117
Fund 52		1,068
Fund 54		<u>3,745</u>
Total General Checking Account	5,092,004	4,111,424
Activity and Trust Funds	310,006	292,466
Fund 360	67,687	67,565
Debt Service Funds	<u>69,362</u>	<u>69,362</u>
TOTALS	\$ 5,539,059	\$ 4,540,817

Breakdown per financial statements:

Governmental Funds	\$ 3,593,421
Proprietary Funds	654,930
Agency Funds	<u>292,466</u>
TOTALS	\$ 4,540,817

PENDLETON COUNTY SCHOOL DISTRICT
 NOTES TO THE FINANCIAL STATEMENTS
 June 30, 2003

NOTE D – CAPITAL ASSETS

Capital asset activity for the fiscal year ended June 30, 2003, was as follows:

Governmental Activities	Balance July 1, 2002	Additions	Deductions	Balance June 30, 2003
Land and land improvements	\$263,565	\$1,575,197		\$1,838,762
Buildings and improvements	18,120,004			18,120,004
Technology equipment	1,280,453	290,491		1,570,944
Vehicles	2,562,274	129,078		2,691,352
General equipment	732,782	83,453		816,235
Construction in progress	506,194	2,093,513	1,418,007	1,181,700
Totals at historical cost	23,465,272	4,171,732	1,418,007	26,218,997
Less: accumulated depreciation				
Land improvements	116,888	55,801		172,689
Buildings and improvements	5,185,898	397,837		5,583,735
Technology equipment	815,293	291,697		1,106,990
Vehicles	1,567,609	188,895		1,756,504
General equipment	<u>302,361</u>	<u>51,303</u>		<u>353,664</u>
Total accumulated depreciation	7,988,049	985,533		8,973,582
Governmental Activities Capital Assets - Net	\$15,477,223	\$3,186,199	\$1,418,007	\$17,245,415

Business-Type Activities

Buildings and improvements	\$875,390		\$875,390
Vehicles	5,500		5,500
General equipment	<u>477,867</u>	<u>86,803</u>	<u>564,670</u>
Totals at historical cost	1,358,757	86,803	1,445,560
Less: accumulated depreciation			

Buildings and improvements	242,035	17,508	259,543
Vehicles	3,758	1,100	4,858
General equipment	<u>262,081</u>	<u>41,576</u>	<u>303,657</u>
Total accumulated depreciation	507,874	60,184	568,058

Business-Type Activities Capital			
Assets - Net	\$850,883	\$26,619	\$877,502

Depreciation expense was not allocated to governmental functions. It appears on the statement of activities as "unallocated".

PENDLETON COUNTY SCHOOL DISTRICT
NOTES TO THE FINANCIAL STATEMENTS
June 30, 2003

NOTE E – BONDED DEBT AND LEASE OBLIGATIONS

The amount shown in the accompanying financial statements as lease obligations represents the District's future obligations to make lease payments relating to the bonds issued aggregating The original amount of each issue, the issue date, and interest rates are summarized below:

Issue Date	Proceeds	Rates
1995	\$ 6,670,000	4.80% - 5.05%
1997	790,000	4.00% - 4.95%
1998	2,525,000	3.80% - 4.50%
1999	2,595,000	4.75% - 5.125%
2002	1,390,000	1.60% - 4.55%

The District, through the General Fund (including utility taxes and the Support Education Excellence in Kentucky (SEEK) Capital Outlay Fund) is obligated to make payments in amounts sufficient to satisfy debt service requirements on bonds issued to construct school facilities. The District has an option to purchase the property under lease at any time by retiring the bonds then outstanding.

The District entered into "participation agreements" with the School Facility Construction Commission. The Commission was created by the Kentucky General Assembly for the purpose of assisting local school districts in meeting school construction needs. The table below sets forth the amount to be paid by the District and the Commission for each year until maturity of all bond issues. The liability for the total bond amount remains with the District and, as such, the total principal outstanding has been recorded in the financial statements.

The bonds may be called prior to maturity and redemption premiums are specified in each issue. Assuming no bonds are called prior to scheduled maturity, the minimum obligations of the District, including amounts to be paid by the Commission, at June 30, 2003 for debt service (principal and interest) are as follows:

Fiscal Year	PENDLETON COUNTY SCHOOL DISTRICT		KENTUCKY SCHOOL CONSTRUCTION COMMISSION		Total
	Principal	Interest	Principal	Interest	
2003-2004	496,872	444,649	148,128	103,949	1,193,598
2004-2005	515,219	423,441	154,781	97,296	1,190,737
2005-2006	548,171	401,007	161,829	90,249	1,201,256

2006-2007	565,701	376,503	169,299	82,779	1,194,282
2007-2008	592,782	350,803	177,218	74,860	1,195,663
2008-2009	619,449	322,970	185,551	66,524	1,194,494
2009-2010	646,255	293,968	128,745	59,247	1,128,215
2010-2011	682,250	262,921	132,750	53,041	1,130,962
2011-2012	713,780	228,999	116,220	47,105	1,106,104
2012-2013	743,559	193,455	121,441	41,282	1,099,737
2013-2014	787,403	155,908	127,597	35,127	1,106,035
2014-2015	825,967	116,147	134,033	28,690	1,104,837
2015-2016	869,227	74,215	130,773	22,166	1,096,381
2016-2017	373,217	49,950	101,783	16,465	541,415
2017-2018	393,001	31,457	106,999	11,248	542,705
2018-2019	<u>287,519</u>	<u>14,735</u>	<u>112,481</u>	<u>5,765</u>	<u>420,500</u>
TOTALS	9,660,372	3,741,128	2,209,628	835,793	16,446,921

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PENDLETON COUNTY SCHOOL DISTRICT
NOTES TO THE FINANCIAL STATEMENTS
June 30, 2003

NOTE F – CAPITAL LEASE PAYABLE

The District leases buses under capital leases with KISTA. The leases expire on various dates from June 2004 through June 2013.

<u>Classes of Property</u>	<u>Book value as of June 30, 2003</u>
Buses	\$ 898,459

The following is a schedule by years of the future minimum lease payments under capital lease together with the present value of the net minimum lease payments as of June 30, 2003:

<u>Year Ending June 30,</u>	<u>Capital Lease Payable</u>
2004	\$ 224,487
2005	208,949
2006	169,243
2007	145,156
2008	117,063
Thereafter	<u>228,359</u>
Total minimum lease payments	1,093,257
Less: Amount representing interest	<u>(152,719)</u>
Present Value of Net Minimum Lease Payments	\$ <u>940,538</u>

NOTE G – COMMITMENTS UNDER NONCAPITALIZED LEASES

Commitments under operating lease agreements for office equipment provide the minimum future rental payments as of June 30, 2003 as follows:

Year ending June 30:

2004	\$	47,309
2005		32,867
2006		15,132
2007		<u>999</u>
Total minimum payments	\$	<u>96,307</u>

PENDLETON COUNTY SCHOOL DISTRICT
NOTES TO THE FINANCIAL STATEMENTS
June 30, 2003

NOTE H – RETIREMENT PLANS

Plan Description – The Pendleton County School District contributes to the Teachers' Retirement System of Kentucky (KTRS), a cost sharing, multiple employer defined benefit pension plan. KTRS administers retirement and disability annuities, and death and survivor benefits to employees and beneficiaries of employees of the public school systems and other public educational agencies in Kentucky.

KTRS was created by the 1938 General Assembly and is governed by Chapter 161 Section 220 through Chapter 161 Section 990 of the Kentucky Revised Statutes (KRS). KTRS issues a publicly available financial report that includes financial statements and required supplementary information for the defined benefit pension plan. That report can be obtained by writing to Kentucky Teachers' Retirement System, 479 Versailles Road, Frankfort, KY 40601.

Funding Policy – Contribution rates are established by KRS. Members are required to contribute 9.855% of their salaries to KTRS. The Commonwealth of Kentucky is required to contribute 13.105% of salaries. KRS requires that members of KTRS occupy a position requiring either a four (4) year college degree or certification by KY Department of Education (KDE).

Substantially all other employees (classified personnel) are covered under the County Employee's Retirement System ("CERS"), a cost sharing, multiple-employer, public employers retirement system. Funding for the Plan is provided through payroll withholdings of 5% and a District contribution of 6.34% of the employee's total compensation subject to contribution.

The District's total payroll for the year was \$11,558,059. The payroll for employees covered under KTRS was \$8,171,848 and for CERS was \$2,636,416.

The contribution requirement for CERS for the year ended June 30, 2003 was \$299,004 which consisted of \$166,782 from the District and \$132,222 from the employees. The District paid \$71,741 from federal grant monies to KTRS in matching contributions for federally funded employees.

Benefits under both plans will vary based on final compensation, years of service and other factors as fully described in the Plan documents.

The "pension benefit obligation" is a standardized disclosure measure of the present value of pension benefits, adjusted for the effects of projected salary increases and step-rate benefits, estimated to be payable in the future as a result of employee service to date. The measure, which is the actuarial present value of credited projected benefits, is intended to help users assess the pensions' funding status on a going-concern basis, assess progress made in accumulating sufficient assets to pay benefits when due, and make comparisons among the plans and employers.

KTRS and CERS do not make separate measurements of assets and pension benefit obligation for individual employers. The following table presents certain information regarding the plans' status as a whole, derived from actuarial valuations performed as of the dates indicated:

PENDLETON COUNTY SCHOOL DISTRICT
NOTES TO THE FINANCIAL STATEMENTS
June 30, 2003

As the District is only one of several employers participating in the Plan, it is not practicable to determine the District's portion of the unfunded past service cost or the vested benefits of the District's portion of the Plan assets.

The District also offers employees the option to participate in a defined contribution plan under Section 403(B), 401(K) and 457 of the Internal Revenue Code. All regular full-time and part-time employees are eligible to participate and may contribute up to the maximum amount allowable by law. The District does not contribute to these plans.

NOTE I - CONTINGENCIES

The District receives funding from Federal, State and Local government agencies and private contributions. These funds are to be used for designated purposes only. For government agency grants, if based upon the grantor's review, the funds are considered not to have been used for the intended purpose, the grantors may request a refund of monies advanced, or refuse to reimburse the District for its disbursements. The amount of such future refunds and unreimbursed disbursements, if any, is not expected to be significant. Continuation of the District's grant programs is predicated upon the grantors' satisfaction that the funds provided are being spent as intended and the grantors' intent to continue their programs.

NOTE J - INSURANCE AND RELATED ACTIVITIES

The District is exposed to various forms of loss of assets associated with the risks of fire, personal liability, theft, vehicular accidents, errors and omissions, fiduciary responsibility, etc. Each of these risk areas is covered through the purchase of commercial insurance. The District has purchased certain policies which are retrospectively rated which includes Workers' Compensation insurance.

NOTE K – ACCUMULATED UNPAID SICK LEAVE BENEFITS

Upon retirement from the school system, a certified employee will receive from the district an amount equal to 30% of the value of accumulated sick leave. At June 30, 2003, this amount totaled \$275,395 for those certified employees with 27 or more years of experience, of which \$137,698 is reserved in the current year fund balance of the General Fund.

NOTE L – INTERFUND RECEIVABLES AND PAYABLES

Interfund balances at June 30, 2003, consisted of the following:

<u>Receivable Fund</u>	<u>Payable Fund</u>	<u>Amount</u>
None		

PENDLETON COUNTY SCHOOL DISTRICT NOTES TO THE FINANCIAL STATEMENTS June 30, 2003

NOTE M – RISK MANAGEMENT

The District is exposed to various risks of loss related to torts; theft of, damage to, and destruction of assets; errors and omissions; injuries to employees; and natural disasters. To obtain insurance for workers' compensation, errors and omissions, and general liability coverage, the District purchases various insurance policies, including participating in the Kentucky School Boards Insurance Trust Liability Insurance Fund. These public entity risk pools operate as common risk management and insurance programs for all school districts and other tax supported educational agencies of Kentucky who are members of the Kentucky School Boards Association. The district pays an annual premium to each fund for coverage. Contributions to the Workers' Compensation Fund are based on premium rates established by such fund in conjunction with the excess insurance carrier, subject to claims experience modifications and a group discount amount. Dividends may be declared, but are not payable until twenty-four (24) months after the expiration of the self-insurance term. The Liability Insurance fund pays insurance premiums of the participating members established by the insurance carrier. The Trust can terminate coverage if it is unable to obtain acceptable excess general liability coverage and for any reason by giving ninety (90) days notice. In the event the Trust terminated coverage, any amount remaining in the Fund (after payment of operational and administrative costs and claims for which coverage was provided) would be returned to the member on a pro rata basis. The District purchased unemployment insurance through the Kentucky School Boards Insurance Trust Unemployment Compensation Fund; however, risk has not been transferred to such fund. In addition, the District continues to carry commercial insurance for all other risks of loss. Settled claims resulting from these risks have not exceeded commercial insurance coverage in any of the past three fiscal years.

NOTE N – DEFICIT OPERATING/FUND BALANCES

Funds with a current year deficit of revenues over expenditures	
Debt Service Fund	\$ (72,963)

NOTE O – COBRA

Under COBRA, employers are mandated to notify terminated employees of available continuing insurance coverage. Failure to comply with this requirement may put the school district at risk for a substantial loss. The District sends out COBRA letters to terminated employees within 30 days.

PENDLETON COUNTY SCHOOL DISTRICT
NOTES TO THE FINANCIAL STATEMENTS
June 30, 2003

NOTE P – TRANSFER OF FUNDS

The following transfers were made during the year.

<u>Type</u>	<u>From Fund</u>	<u>To Fund</u>	<u>Purpose</u>	<u>Amount</u>
Operating	1	2	KETS Matching	\$ 21,338
Operating	51	1	Indirect Cost	64,098
Debt Service	310	400	Bond Payment	249,527
Debt Service	320	400	Bond Payment	568,735
Construction	1	360	BG 02-231	200,000
Construction	320	360	BG 02-382	110,800
Construction	320	360	BG 02-042	455,624
Close Out Inactive	400	1	Close inactive	1,892
Debt Service	1	400	Energy Bond	35,132

NOTE Q – ON-BEHALF PAYMENTS

The financial statements include payments made by the Commonwealth of Kentucky for insurance, flexible spending, vocational and retirement benefits. The following amounts are included in each of the functions.

Instruction	\$ 1,822,654
Support Services	
Student	125,603
Instructional Staff	32,657
District Administration	12,560
School Administration	37,681
Business	5,024
Plant Operations and Maintenance	55,265
Student Transportation	153,236

Central Office	10,048
Community Services	<u>35,169</u>
Total	\$ 2,289,897

PENDLETON COUNTY SCHOOL DISTRICT
NOTES TO THE SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
Year Ended June 30, 2003

Note 1 – Basis of Presentation

The accompanying schedule of expenditures of federal awards includes the federal grant activity of Pendleton County School District and is presented on the modified accrual basis of accounting. The information in this schedule is presented in accordance with the requirements of OMB Circular A-133, Audits of States, Local Governments, and Non-Profit Organizations. Therefore, some amounts presented in this schedule may differ from amounts presented in, or used in the preparation of the general purpose financial statements.

Note 2 – Food Distribution

Nonmonetary assistance is reported in the schedule at the fair market value of the commodities disbursed.

REPORT ON COMPLIANCE AND ON THE INTERNAL CONTROL OVER FINANCIAL
REPORTING BASED ON AN AUDIT OF THE FINANCIAL STATEMENTS PERFORMED IN
ACCORDANCE WITH GOVERNMENT AUDITING STANDARDS

State Committee For School District Audits
Members of the Board of Education
Pendleton County School District
Falmouth, Kentucky

I have audited the financial statements of the Pendleton County School District as of and for the year ended June 30, 2003, and have issued my report thereon dated October 27, 2003. I conducted my audit in accordance with auditing standards generally accepted in the United States of America, and the standards applicable to financial audits contained in Government Auditing Standards, issued by the Comptroller General of the United States; the provisions of Office of Management and Budget Circular A-133, Audits of States, Local Governments, and Non-Profit Organizations, and the audit requirement prescribed by Appendix I, II, and III to the independent auditor's contract.

Compliance

As part of obtaining reasonable assurance about whether the Pendleton County School District's financial statements are free of material misstatement, I performed tests of its compliance with certain provisions of laws, regulations, contracts and grants, noncompliance with which could have a direct and material effect on the determination of the financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of my audit and, accordingly, I do not express such an opinion. I noted certain immaterial instances of noncompliance that I have reported to management in a separate letter dated October 27, 2003.

Internal Control Over Financial Reporting

In planning and performing my audit, I considered the District's internal control over financial reporting in order to determine my auditing procedures for the purpose of expressing my opinion on the financial statements and not to provide assurance on the internal control over financial reporting. I noted no matters involving the internal control over financial reporting and its operation that I consider to be reportable conditions, except as noted below. Reportable conditions involve matters coming to my attention relating to significant deficiencies in the design or operation of the internal control over financial reporting that, in my judgment, could adversely affect the District's ability to record, process, summarize and report financial data consistent with the assertions of management in the financial statements.

For the Middle School activity fund, responsibilities for collecting and recording receipts are performed by the same individual.

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A material weakness is a condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. My consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control that might be reportable conditions and accordingly, would not disclose all reportable conditions that are also considered to be material weaknesses.

However, I noted certain matters involving the internal control over financial reporting that I have reported to the management of the District in a separate letter dated October 27, 2003.

In addition, the results of my tests disclosed no instances of noncompliance of specific state statutes or regulations identified in Appendix II of the Independent Auditor's Contract – State Audit Requirements, except as indicated below.

The District did not comply with Bid Laws (KRS 424.260) in dealing with one vendor during the year.

The District did not comply with KRS 156.480 by purchasing items for resale from the school treasurer at Phillip A Sharp Middle School.

This report is intended for the information of management, the Kentucky Department of Education, federal awarding agencies, and pass-through entities and is not intended to be and should not be used by anyone other than these specified parties.

Denise M. Keene, CPA

October 27, 2003

REPORT ON COMPLIANCE WITH REQUIREMENTS APPLICABLE TO EACH
MAJOR PROGRAM AND INTERNAL CONTROL OVER COMPLIANCE IN
ACCORDANCE WITH OMB CIRCULAR A-133

State Committee For School District Audits
Members of the Board of Education
Pendleton County School District
Falmouth, Kentucky

I have audited the compliance of the Pendleton County School District with the types of compliance requirements described in the U.S. Office of Management and Budget (OMB) Circular A-133 Compliance Supplement that are applicable to each of its major federal programs for the year ended June 30, 2003. The District's major federal programs are identified in the summary of auditors results section of the accompanying schedule of findings and questioned costs. Compliance with the requirements of laws, regulations, contracts and grants applicable to each of its major federal programs is the responsibility of the District's management. My responsibility is to express an opinion on the District's compliance based on my audit.

I conducted my audit of compliance in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in Government Auditing Standards, issued by the Comptroller General of the United States; and OMB Circular A-133, Audits of States, Local Governments, and Non-Profit Organizations and the audit requirements prescribed by Appendix I, II, and III to the independent auditor's contract. Those standards and OMB Circular A-133 require that I plan and perform the audit to obtain reasonable assurance about whether noncompliance with the types of compliance requirements referred to above that could have a direct and material effect on a major federal program occurred. An audit includes examining, on a test basis, evidence about the District's compliance with those requirements and performing such other procedures as I considered necessary in the

circumstances. I believe that my audit provides a reasonable basis for my opinion. My audit does not provide a legal determination on the District's compliance with those requirements.

In my opinion, the District complied, in all material respects, with the requirements referred to above that are applicable to each of its major federal programs for the year ended June 30, 2003. The results of my auditing procedures disclosed no instances of noncompliance with those requirements that are required to be reported in accordance with OMB Circular A-133 and which are to be reported in the accompanying schedule of findings and questioned costs.

Internal Control Over Compliance

The management of the Pendleton County School District is responsible for establishing and maintaining effective internal control over compliance with requirements of laws, regulations, contracts and grants applicable to federal programs. In planning and performing my audit, I considered the District's internal control over compliance with requirements that could have a direct and material effect on a major federal program in order to determine my auditing procedures for the purpose of expressing my opinion on compliance and to test and report on internal control over compliance in accordance with OMB Circular A-133.

My consideration of the internal control over compliance would not necessarily disclose all matters in the internal control that might be material weaknesses. A material weakness is a condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that noncompliance with applicable requirements of laws, regulations, contracts and grants that would be material in relation to a major federal program being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. I noted no matters involving the internal control over compliance and its operations that I consider to be material weakness.

This report is intended for the information of management, the Kentucky Department of Education, federal awarding agencies, and pass-through entities and is not intended to be and should not be used by anyone other than these specified parties.

Denise M. Keene, CPA
October 27, 2003

PENDLETON COUNTY SCHOOL DISTRICT
 SCHEDULE OF FINDINGS AND QUESTIONED COSTS
 Year Ended June 30, 2003

Section I – Summary of Auditor's Results

Financial Statements

A qualified opinion was issued on the financial statements.

Internal control over financial reporting

Material weakness(es) identified? ☐ yes ☒ no

Reportable condition(s) identified that are not
 considered to be material weakness(es)? ☒ yes ☐ none reported

Noncompliance material to financial statements noted? ☐ yes ☒ no

Federal Awards

Internal control over major programs:

Material weakness(es) identified? ☐ yes ☒ no

Reportable conditions(s) identified that are not
 Considered to be material weakness(es)? ☐ yes ☒ none reported

An unqualified opinion was issued on compliance for all major programs.

Any audit findings disclosed that are required to be reported
 in accordance with section 510(a) of Circular A-133? ☐ yes ☒ no

Identification of major programs

<u>CFDA Number(s)</u>	<u>Name of Federal Program or Cluster</u>
10.553, 10.555, 10.559	Nutrition Cluster
84.010	Title I

Dollar threshold used to distinguish between type A and type B programs: \$300,000

Auditee qualified as low-risk auditee?

☐ yes ☒ no

Section II – Financial Statement Findings

No matters were reported

Section III – Federal Award Findings and Questioned Costs

No matters were reported

PENDLETON COUNTY SCHOOL DISTRICT
SCHEDULE OF PRIOR YEAR AUDIT FINDINGS
Year Ended June 30, 2003

There were no prior year findings,

MANAGEMENT LETTER

Pendleton County Board of Education
Falmouth, Kentucky

I have audited the financial statements of the Pendleton County School District for the year ended June 30, 2003 and have issued my report thereon dated October 27, 2003. As part of my audit, I made a study and evaluation of the District's system of internal accounting control to the extent I considered necessary to evaluate the system as required by auditing standards generally accepted in the United States of America. The purpose of my study and evaluation was to determine the nature, timing and extent of the auditing procedures necessary for expressing an opinion on the District's financial statements. My study and evaluation was more limited than would be necessary for expressing an opinion on the system of internal accounting control taken as a whole.

The management of the Pendleton County School District is responsible for establishing and maintaining a system of internal accounting control. In fulfilling this responsibility, estimates and judgements by management are required to assess the expected benefits and related costs of control procedures. The objectives of a system are to provide management with reasonable, but not absolute, assurance that assets are safeguarded against loss from unauthorized use or disposition, and that transactions are executed in accordance with management's authorization and recorded properly to permit the preparation of financial statements in accordance with generally accepted accounting principles.

Because of inherent limitations in any system of internal accounting control, errors, or irregularities may nevertheless occur and not be detected. Also, projections of any evaluation of the system to future periods is subject to the risk that procedures may become inadequate because of changes in conditions or that the degree of compliance with procedures may deteriorate.

My study and evaluation made for the limited purpose described in the first paragraph would not necessarily disclose all material weaknesses in the system of internal accounting control. Accordingly, I do not express an opinion of the system of internal accounting control of the Pendleton County School District taken as a whole. My study and evaluation disclosed no condition that I believe to be a material weakness.

The following items from last year's management letter were corrected during the current fiscal year as outlined in the District's response.

02-01, 02-02, 02-03, 02-05, 02-06, 02-07, 02-09, 02-10, 02-11, 02-12, 02-13, 02-14, 02-15, 02-16, 02-17, 02-18, 02-19, 02-20, 02-21, 02-22, 02-23, 02-24, 02-25, 02-26, 02-28, 02-30, 02-31, 02-32, 02-34, 02-35, 02-36, 02-37, 02-38, 02-39, 02-40, 02-41, 02-42, 02-43, 02-44, 02-45, 02-45, 02-47, 02-49

The following items from last year's management letter were not corrected during the current fiscal year.

02-04, 02-08, 02-27, 02-29, 02-33, 02-48, 02-50

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There were no material weaknesses identified in last year's audit report. There was one reportable condition identified "nonsegregation of duties at the school level. That has been corrected at all of the schools except the Middle School.

CURRENT YEAR MANAGEMENT POINTS

03-01 Accounting manuals should to be done. This would assist in a smooth transition if an employee change occurred. This was a recommendation in last year's management letter.

Management's response: Samples from a neighboring district will be used to develop our own accounting manuals.

03-02 The District did not comply with bid laws on one vendor. This occurred when the food service director received quotes from a vendor, but never presented the quotes to the Board for approval. I recommend the District review its vendor totals during the year to monitor compliance with bid laws. This was also identified in last year's management letter.

Management's response: Any quotes obtained by administrators for District purchases will be presented to the Board for approval. Vendor totals will be monitor on a quarterly basis to assure compliance with bid laws.

03-03 Payroll testing revealed that at least one of the bus drivers timesheets were not being approved by a supervisor, contracts are not done for summer student workers, and an I-9

form was not obtained for a student worker. I recommend the District review its payroll policies and procedures to ensure compliance at all levels.

Management's response: The Personnel Director will be instructed to ensure compliance with contracts and I-9s on all workers. The transportation secretary will assure all bus driver timesheets are properly signed by the supervisor before submitting to the payroll clerk.

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NORTHERN ELEMENTARY SCHOOL

Northern Elementary School corrected all six management letter comments from last year. They do not have any new comments for the current year. They are to be commended for their efforts.

SOUTHERN ELEMENTARY SCHOOL

Southern Elementary School corrected all of the management letter comments from last year.

03-04 There is an unreasonable time delay between the date of the teacher multiple receipt form and the date of the school treasurer's receipt. Receipts are being deposited timely once received by the school treasurer. All money collected by a teacher should be given to the school treasurer on the day collected. I recommend the Principal instruct teachers to turn in money collected on a daily basis.

Management's response: All money collected by teachers will be given to the school treasurer on the day they are collected to effectively eliminate the time delay between the date of the teacher multiple receipt form and the date of the school treasurer's receipt. All teachers will be instructed immediately of this plan.

PHILLIP A SHARP MIDDLE SCHOOL

03-06 The segregation of duties for handling receipts needs to be improved. Currently the bookkeeper receives the money, makes the deposit, and records the transactions. The "Red Book" suggests:

Person #1 (Clerk)

- Opens the mail but does not open bank statements
- Records the checks by payee in chronological order
- Receives cash and writes pre-numbered receipt for cash to payee

Person #2 (School Treasurer)

- Photocopies the checks (Optional, but encouraged)
- Records receipts on a deposit ticket
- Records revenue in school accounting system to agree with the deposit tickets

Person #3 (Principal)

- Reconciles the log produced by person #1 to the deposit ticket
- Deposits checks and cash.

I recommend the school improve the segregation of duties for handling receipts. This was in last year's management letter. According to the internal control questionnaire, it is still a problem.

Management's Response: As stated in last year's letter for plan of action, person 1 and 2 will be taken care of by both parties. Person #1 will receive cash/checks and register all cash received on form FSA 6 along with signature of person remitting cash and the date. Person #2 will still perform duties listed. Person #3 has, however, been opening the bank statement and signing it since the meeting with the auditor last year 2002-03. As stated in last years letter, all duties for person 1 and 2 will be taken care of by both parties.

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PHILLIP A SHARP MIDDLE SCHOOL

03-07 Ticket sales forms are not being used. Pre-numbered tickets shall be used for ALL events for which admission is charged. I recommend the school use the Requisition and Report of Ticket Sales (Form F-SA-1) for all events for which admission is charged. This was in last year's management letter. There were a few ticket sale forms used, but not for all of the events that should have used them.

Management's Response: Due to a personnel change this school year, the ticket sale recommendation has been dully noted and has been in effect as of the first event this school year.

03-08 The school did not comply with KRS 156.480 by purchasing items for resale from the school treasurer. I recommend the school review KRS 156.480 and prohibit any purchases from school employees that would violate the law.

Management's Response: The recommendation of the review of this law has taken place and therefore, the party mentioned has set a plan in to action to no longer be accessible for such named activities.

PENDLETON COUNTY HIGH SCHOOL

03-09 Documentation required from Booster Clubs is not being obtained. I recommend the school require Booster Clubs to: submit the names of the club officers to the Principal at the beginning of the school year; submit an annual booster club budget to the Principal within the first thirty days of the school year; and submit an annual financial report to the Principal by July 25 for the year ended June 30. This was included in last year's management letter.

Management's Response: Greater attention will be given to acquire proper information from booster groups. The Principal has meet with representative from all groups; however, this remains a concern. The Principal will make every effort to get all club officers and a budget as

soon as possible. The groups will not be allowed to conduct fundraisers until the officers and budgets are received. All groups will be required to submit the annual financial report by July 25 or will not be allowed to conduct fundraisers until it is received.

03-10 The annual financial report did not include a certificate of deposit owned by the school. I recommend the annual financial report include all cash owned by the school. This was included in last year's management letter.

Management's Response: After consultation with the auditor, the school treasurer has corrected the annual financial report to reflect the C.D. owned by the school.

03-11 There is an unreasonable time delay between the date of the teacher receipt and the date of the school treasurer's receipt. Receipts are being deposited timely once received by the school treasurer. All money collected by a teacher should be given to the school treasurer on the day collected. I recommend the Principal instruct teachers to turn in money collected on a daily basis.

Management's Response: At the next faculty meeting, the Principal will instruct the high school staff to turn in money collected on a daily basis and not wait.

